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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B03  
PLR-144760-12

Date:  
April 11, 2013

LEGEND

X =

Trust =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This letter responds to a letter dated October 12, 2012, and subsequent correspondence, written on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

### Facts

According to the information submitted and the representations made, X was incorporated under the laws of State on Date 1. On Date 2, shares of X's stock were transferred to Trust. X elected to be an S corporation effective Date 3. X represents that Trust was qualified to be an Electing Small Business Trust (ESBT), within the meaning of § 1361(e), however, no election was made under § 1361(e)(3) to treat Trust as an ESBT. Consequently, Trust was an ineligible shareholder, and, as a result, X's S corporation election was ineffective.

X represents that the circumstances resulting in the ineffectiveness of X's S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. X and X's shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

### Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible shareholder and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made

and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year which made (determined without regard to § 1361(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents; (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in such ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) of the Income Tax Regulations provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

### Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election effective Date 3 was inadvertently invalid because X had an ineligible shareholder. Pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 3 and thereafter, provided that X's S corporation election is not otherwise terminated under § 1362(d), so long as the trustee of Trust files an ESBT election effective Date 3 with the appropriate service center within 120 days of the date of this letter. A copy of this letter should be attached to the ESBT election.

Accordingly, the shareholders of X must include in their income their pro rata share of separately stated and nonseparately computed items of X as provided in § 1366 and make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. This ruling is contingent upon X and each of its shareholders filing any amended returns and making such adjustments that

are necessary to properly reflect the reporting of X's items of S corporation income. Specifically, Trust must file an amended return and make adjustments that are necessary to properly reflect the treatment of Trust as an ESBT.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

If all of the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the Ogden Service Center that its S corporation election is not valid.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation or Trust's eligibility to be an ESBT.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Stacy L. Short  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2):

A copy of this letter  
A copy for § 6110 purposes